

DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: April 11, 2007
POSITION: Neutral
SPONSOR: Board of Equalization, Attorney General's Office

BILL NUMBER: SB 554
AUTHOR: C. Migden

BILL SUMMARY: Definition of cigarette

This bill would revise the definition of cigarette under the state tax law, the Proposition 99, and the Proposition 10 to mean any product that contains nicotine, which is intended to be burned or heated under ordinary conditions of use, and meets one of several conditions as provided.

FISCAL SUMMARY

Based on the Board of Equalization's (BOE) draft analysis, this bill could result in combined net annual excise tax and sales tax revenue gains of \$1.2 million in 2007-08 and \$2.4 million in 2008-09, \$0.3 million and \$0.7 million of which would be to the General Fund in the respective fiscal years. This bill would not materially impact the BOE's administrative costs.

COMMENTS

The Department of Finance is neutral on this bill and notes this bill would result in the General Fund revenue increases of \$0.3 million in 2007-08 and \$0.7 million in 2008-09, and is intended to do the following:

- Reduce the confusion due to multiple, inconsistent definitions of a cigarette.
- Prevent easy tax avoidance by revising the current weight-based definition of a cigarette under the existing excise tax law, which is often subject to intentional mislabeling by the precise manipulation of the item's weight.
- Bring fairness to the marketplace by classifying, treating, and taxing as a cigarette any product that functions like a cigarette.
- Strengthen the Department of Justice's and the BOE's ability to diligently enforce the Model Statute, which protects the State's \$800 million annual income stream from the Master Settlement Agreement (MSA).
- Help the distributors' determination of the products that are required to have a stamp affixed for tax purposes and products are in compliance with the MSA or the Model Statute by simply referring to the Tobacco Directory.

Note: This bill would require a four-fifths vote for passage.

Analyst/Principal (0727) P. Ng	Date	Program Budget Manager Mark Hill	Date
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Department Deputy Director	Date
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Governor's Office:	By:	Date:	Position Approved _____
			Position Disapproved _____

BILL ANALYSIS	Form DF-43 (Rev 03/95 Buff)
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ANALYSIS**A. Programmatic Analysis**

Under current state law, cigarettes are taxed by the state at a rate of 87 cents per package of 20, with 10 cents per package transferred to the General Fund, 25 cents per package allocated to the Cigarette and Tobacco Products Surtax Fund (i.e., pursuant to Proposition 99 as adopted by voters in November 1988), 2 cents per package deposited in the Breast Cancer Fund, and 50 cents per package deposited in the Children and Families First Trust Fund Account (i.e., pursuant to Proposition 10 as adopted by voters in December 1998). This excise tax is paid by distributors through the use of stamps or meter impressions. The cost of these stamps is passed on by the distributors to their retail customers and ultimately to the consumer.

In addition to the tax on cigarettes, an excise tax is imposed on other tobacco products, such as cigars, chewing tobacco, pipe tobacco, and snuff. This rate is determined annually on March 1 by the Board of Equalization based on the wholesale cost of tobacco products. The current rate is 46.76 percent. Revenues from other tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund (i.e., Proposition 99) and to the California Children and Families First Trust Fund (i.e., Proposition 10).

Current law also imposes a sales or use tax on the sale or purchase of tangible personal property in this state (including tobacco products). When a person sells tobacco products at retail in this state, the sales tax applies.

The existing state law defines "cigarette" to mean any roll for smoking, made wholly or in part of tobacco, irrespective of size or shape and irrespective of whether the tobacco is flavored, adulterated or mixed with any other ingredient, where such roll has a wrapper or cover made of paper or any other material, except where such wrapper is wholly or in the greater part made of tobacco and such roll weighs over three pounds per thousand.

For purposes of Proposition 99, the term "cigarette" is defined to have the same meaning as under the existing state law, as it read on January 1988, and any changes to it requires a vote of four-fifths of the membership of both houses of the Legislature.

For purposes of Proposition 10, the term "cigarette" is also defined to have the same meaning as under the existing state law, as it read on January 1997, and any changes to it requires a vote of two-thirds of the membership of both houses of the Legislature.

Master Settlement Agreement (MSA)

The MSA and the two laws that implement the MSA, the Model Statute and the Complementary Legislation (Tobacco Directory Law), define a "cigarette" to mean the following:

Any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains any of the following:

- Any roll of tobacco wrapped in paper or in any substance not containing tobacco.
- Tobacco, in any form, that is functional in the product, which because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette.

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- Any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette.

"Cigarette" also includes "roll-your-own" tobacco, meaning any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

This bill would, effective January 1, 2008, revise the definition of "cigarette" under the existing state law, the Proposition 99, and the Proposition 10, in order to conform to that of the MSA's, to mean the following:

"Any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (a) any roll of tobacco wrapped in paper or in any substance not containing tobacco; (b) tobacco, in any form, that is functional in the product, which because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (c) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in this section."

Discussion

According to the draft analysis prepared by the Board of Equalization's (BOE) staff, this bill is co-sponsored by the Attorney General (AG) and the BOE, and is intended to do the following:

- Reduce confusion due to multiple, inconsistent definitions of cigarette.
- Prevent easy excise and sales tax avoidance by revising the weight-based definition of a cigarette under the existing excise tax law, which is often subject to intentional mislabeling.
- Bring fairness to the marketplace by classifying, treating, and taxing as a cigarette any product that functions like a cigarette.
- Strengthen the AG's and the BOE's ability to diligently enforce the Model Statute, which protects the state's \$800 million annual income stream from the MSA. The annual income stream from the MSA may be at risk if a court or arbitration panel were to determine that California had failed to diligently enforce the Model Statute as required by the MSA.

By creating a uniform definition of cigarette under California law, this bill could also help the distributor's determination of the following:

- Products that are required to have a stamp affixed for tax purposes.
- Products are in compliance with the MSA or the Model Statute by simply referring to the Tobacco Directory.

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B. Fiscal Analysis

The Board of Equalization (BOE)'s draft analysis of this bill estimates that this bill could result in combined annual excise tax and sales tax revenue gains of \$1.2 million in 2007-08 and \$2.4 million in 2008-09 as follows:

	In Millions	
	2007-08	2008-09
Excise Taxes	\$1.031	\$2.062
General Fund	\$0.349	\$0.698
Breast Cancer	\$0.070	\$0.140
Proposition 99	-\$0.402	-\$0.803
Proposition 10	\$1.014	\$2.027
Sales and Use Taxes	\$0.154	\$0.308
State	\$0.102	\$0.204
Local	\$0.039	\$0.078
Transit	\$0.013	\$0.027
Total Excise and Sales Taxes*	\$1.185	\$2.370

* Amounts may not add up to totals due to rounding.

The estimated revenue gains listed in the above are primarily resulting from certain tobacco products, (e.g., "cigarette-like cigars") under the current state law which would be deemed to be cigarettes for tax purposes under this bill.

The draft analysis prepared by the BOE's staff also estimates that this bill would not materially impact the BOE's administrative costs

BILL ANALYSIS/ENROLLED BILL REPORT--(CONTINUED)**Form DF-43****AUTHOR****AMENDMENT DATE****BILL NUMBER**

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Code/Department Agency or Revenue Type	SO	(Fiscal Impact by Fiscal Year)							
	LA	(Dollars in Thousands)							
	CO	PROP							Fund
	RV	98	FC	2006-2007	FC	2007-2008	FC	2008-2009	Code
1105/Cigarette Tax	RV	Yes		--	U	\$349	U	\$698	0001
1105/Cigarette Tax	RV	No		--	U	\$70	U	\$140	0004
1105/Cigarette Tax	RV	No		--	U	-\$402	U	-\$803	0230
1105/Cigarette Tax	RV	No		--	U	\$1,014	U	\$2,027	0623
1149/Sale Use Tax	RV	Yes		--	U	\$102	U	\$204	0001
L149/Loc Rev Sale	RV	No		--	U	\$39	U	\$78	0331
1149/Sale Use Tax	RV	No		--	U	\$13	U	\$27	0055
0880/Scty St	SO	Yes		----- No/Minor Fiscal Impact -----					0001

<u>Fund Code</u>	<u>Title</u>
0001	General Fund
0004	Breast Cancer Fund
0055	Mass Transit Revolving Account STF
0230	Cigarette & Tobacco Products Surtax Fund
0331	Sales Tax Account, Local Revenue Fund
0623	Children & Families First Trust Fd, Cal